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Stuck on a Spoke: Proliferating Bilateral Trade Deals are a Dangerous Game for Canada

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Canada's Minister of International Trade, David Emerson, heralded a free trade agreement with the European Free Trade Association in June by saying "Canada is back in the game." In July, the government announced talks on free trade with Colombia, Peru and CARICOM (the Caribbean Community). While the new agreement is an overdue triumph over special interests, and western-hemisphere liberalization offers economic and political benefits, a broader view of trade policy shows that Canada has fallen behind — and is perhaps even playing in the wrong arena.

To be sure, with the Doha Round of multilateral negotiations in the World Trade Organization stalled, Canada should not merely watch as other countries pursue alternative trade strategies. Rather than poking about various corners of the world for new bilateral trade deals, however, Canada's top priority should be guarding and enhancing links with its most important partner: the United States.

Canadians seem to have forgotten some key trade interests that were front-of-mind 15 years ago. Following the 1988 Canada-US Free Trade Agreement (FTA), many observers saw threats to Canada from proliferating bilateral deals. The main concern was the emergence of hub-and-spoke arrangements — countries with larger economies or better negotiators amassing lots of bilateral arrangements with themselves at the centre.

For Canada, the prospect of life as a single spoke on a US hub was worrisome. Ron Wonnacott,[1] among others, argued that a potential US-Mexican bilateral FTA threatened Canada in two ways. It would undermine support for

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1 See, for example, Wonnacott, Ronald J. 1990. *US Hub-and-Spoke Bilaterals and the Multilateral Trading System*. C.D. Howe Institute Commentary 23; and Canadian-American Committee. 1991. *The Economics of Overlapping Free Trade Areas and the Mexican Challenge*. Canadian-American Committee 60.

multilateral liberalization and the most-favoured-nation principle that had underpinned international trade since World War II in both our North American neighbours, the United States being of special concern. And more pointedly, the United States would occupy a privileged position as the hub for bilateral agreements with Mexico and Canada. Only US producers would have enhanced access to consumers in both spoke countries, and only US intermediate-goods users and consumers would have access to products from both spoke countries. Add more spokes to the US hub, and Canada's relative position would get worse yet.

That separate Canadian agreements with Mexico or other spoke countries could, in principle, address the latter threat was cold comfort. With less to offer prospective partners than the United States, Canada would have a tougher time negotiating barriers down. Like any individual spoke country, Canada would suffer isolation in trade disputes with the United States. And serial US deals with other partners might set protectionist precedents that would hurt Canada in the future.

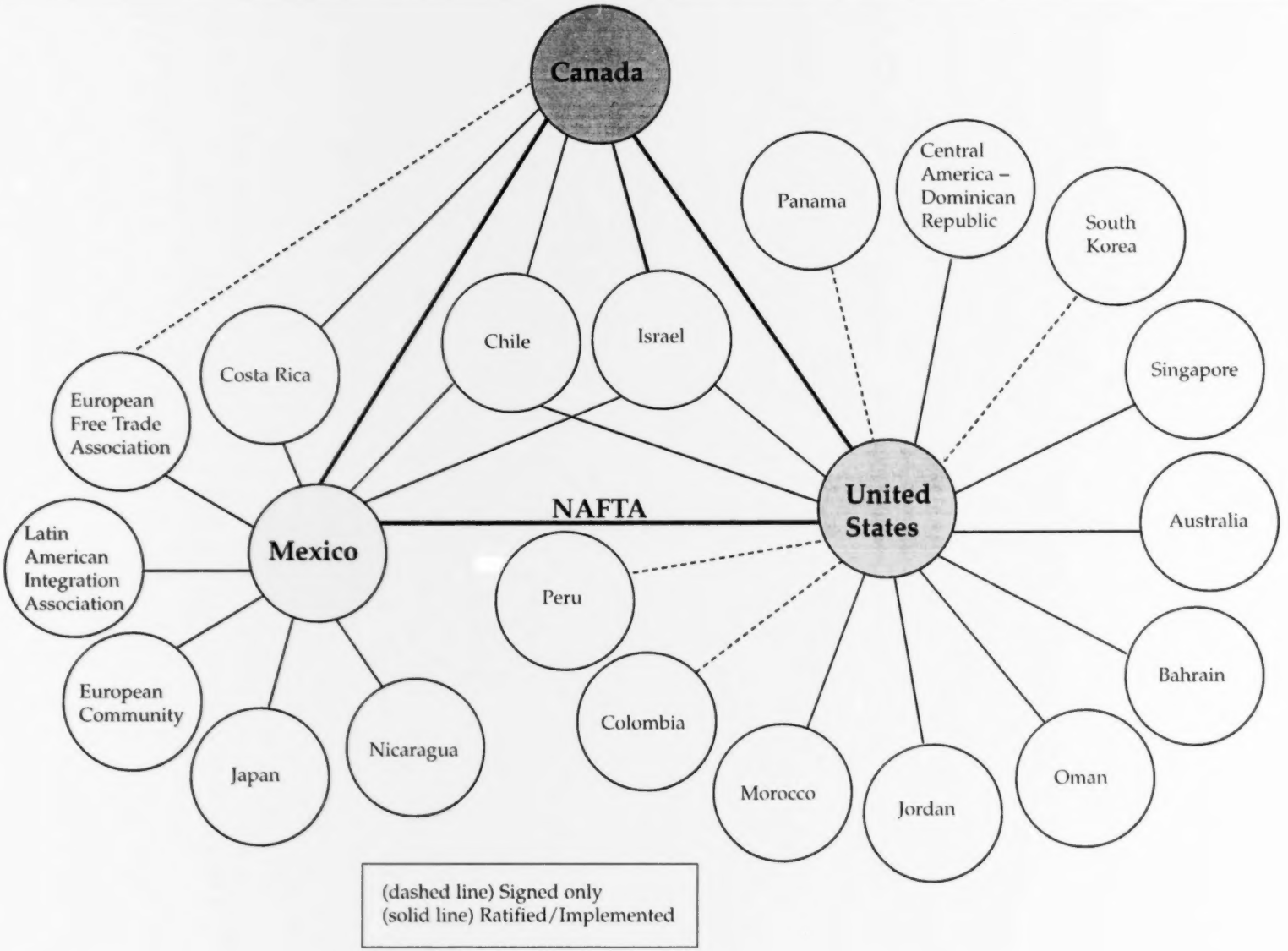
The upshot was that Canada elbowed its way into the US-Mexico negotiations. The resulting North American Free Trade Agreement (NAFTA) in 1994 diluted some Canadian advantages in the US market. Yet a separate US-Mexico bilateral deal would have done that anyway, and there were offsetting advantages. Canada got more durable dispute-resolution machinery — and Canadian intermediate-goods users and consumers got the same access to Mexican products as their US counterparts, boosting Canadian competitiveness and prosperity.

The NAFTA, however, was the beginning and the end of Canada's involvement in US bilaterals. In 1996 Canada signed an FTA with Israel, which had had its own US bilateral since 1985, and in 1997 another with Chile, which did a separate US deal in 2003. But while the former ought to allow trilateral duty-free flows, and while the latter once looked like a precursor to Chile joining the NAFTA, neither has occurred. So Canada has fitfully pursued a handful of other bilaterals. 2001 saw an agreement with Costa Rica, which — along with the other Central American countries and the Dominican Republic — has since done a US deal. But Canadian negotiations with the Andean countries, other Central American countries, the Dominican Republic, Singapore, and South Korea have dragged on for years — with none of the parties feeling much urgency to get them done.

Mexico, meanwhile, has been active on the bilateral front. And, more importantly, the US has added myriad spokes to its hub (Figure 1). It has deals with Bahrain, Jordan, Morocco, Oman, Panama, Singapore, Peru and Colombia. It started talking to South Korea around the same time Canada did, and signed a deal in April of this year.

The US-Australia FTA in 2004 was perhaps most significant for those who recall the dangers of hub-and-spoke arrangements. It vividly showed the reduced interest in multilateralism among key developed countries. Linking the United States to another advanced country with a similar economic profile to its own, it eroded Canada's privileged place in the US market worse than any other US bilateral. Canada should have made an aggressive effort to get inside that agreement — perhaps to bring Australia into the NAFTA. But no such effort occurred.

Figure 1. *North America's Emerging Hub-and-Spoke Trade Systems*



Sources: Office of the United States Trade Representative, Department of Foreign Affairs and International Trade Canada, and WorldTradeLaw.net.

An agreement between the US Congress and administration in May clearing the way for deals with Panama and Peru highlights the final danger: precedents that hurt Canada's interests. Congress required labour standards in those deals — an opening for US protectionist barriers that Canada and Mexico successfully resisted in the NAFTA. Only a resolute optimist would predict that Congress will never seek similar provisions against Canada.

Clearly, the current minority federal government feels ill-placed to liberalize trade. The farmers who profit from cartels in milk, eggs and poultry — even the Canadian Wheat Board — seem now to have enough clout to commit Canada to agricultural interventionism, which has shredded our international credibility and moved us from centre- to side-stage at multilateral talks.

Yet fear of powerful, protected constituencies did not kill previous rounds of multilateral liberalization — nor the Canada-US FTA and the NAFTA. What outweighed it in those past deals was a strategic focus on the game Canada needed to play — and in the NAFTA case, desire to avoid a carving up of world trade by competitive bilateralism that cut Canadians out. What would such a strategic focus entail today?

The best option remains multilateralism. But what if the Doha round is so bogged down, and Canada's agricultural protectionism so pig-headed, that progress on that front is blocked? In that case, Canada could address the hub-and-spoke threat directly, demanding a place at the table whenever the United States held bilateral talks. Yet such a policy would be unappealingly reactive, and if inclusion meant accepting whatever provisions the United States pushed its other partners to accept, Canadians might find access to the hub unattractively costly.

A key further option is to broaden and deepen the bilateral relationship that matters above all others — Canada's relationship with the United States. Regulatory harmonization in goods and services — particularly if achieved as part of discussions between the United States and the European Community — and freer flows of capital and people, offer more benefits and protection against US barriers than anything available from bilateral deals in Latin America or Asia. Agreements on subsidies, or on replacing antidumping laws with common competition policies, are more likely with the United States than with anyone else. Going all the way to a customs union would give Canada's economy a powerful boost, and would ensure inclusion in any further US agreements — powerful security against getting stuck on a spoke.

This option does not preclude pursuing others — but to overcome US protectionism and inertia, not to mention dealing with reservations at home, it must be a clear priority in the government's political and negotiating agenda. The summit of NAFTA leaders in Montebello, August 21 and 22, offers a chance, not only to resist the security-related thickening of North American borders, but to push aggressively for measures that would cement Canada's position as a gateway to the North American market.

Multilateral liberalization demands courage, getting into US bilaterals demands sharp elbows, and a deeper Canada-US economic union requires tough political decisions. All offer greater benefits than proliferating hubs and spokes, and they are better games for Canada to play.

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